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Nos. 04-805 and 04-814

In the Supreme Court of the United States

TEXACO, INC., PETITIONER
v.
FOUAD N. DAGHER, ET AL.

SHELL OIL COMPANY, PETITIONER
v.
FOUAD N. DAGHER, ET AL.

On Writs of Certiorari to the United States Court of Appeals for the Ninth Circuit

MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF VERIZON COMMUNICATIONS INC. AS *AMICUS CURIAE* SUPPORTING PETITIONERS

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MOTION OF VERIZON COMMUNICATIONS INC. TO FILE BRIEF AS *AMICUS CURIAE* SUPPORTING PETITIONERS

Pursuant to Rule 37.3 of the Rules of this Court, Verizon Communications Inc. respectfully moves for leave to file the accompanying brief as *amicus curiae* in support of petitioners. Petitioners have consented to the filing of this brief, but respondents have declined to consent.

This is an easy antitrust case – see U.S. Br. 19 (filed May 26, 2005) (suggesting summary reversal) – and yet the way this Court writes its opinion will have ramifications far beyond litigation over the Equilon joint venture directly at issue.

As a company that often engages in cooperative activity with other businesses to disseminate new products and services that *benefit* consumers, Verizon has a great interest in encouraging this Court to understand the many ways in which such cooperation – and agreements that accompany such cooperation – can be socially and economically beneficial, and should not be condemned under a *per se* rubric that requires an antitrust court to ignore the practices' market effects and justifications. The forms of cooperation that this Court should recognize as pro-consumer include, but are not limited to, formal joint ventures like the one at issue in this case. And the forms of often desirable practices that do not deserve *per se* condemnation, when they are ancillary to legitimate productive cooperation, include but are not limited to what the Ninth Circuit pejoratively labeled the "price fixing" at issue in this case.

Verizon is one of the largest providers of communications services in the United States and in the world. Like other firms in the telecommunications industry, Verizon operates in a business environment that requires large investments to enhance the technological capabilities of its telecommunications network and to develop new services, while at the same time reducing costs and prices. Joint ventures and other cooperative arrangements help Verizon to achieve those goals. Verizon and other telecommunications companies rely on many forms of cooperative arrangements to bring new services to the market and to reduce the cost and improve the quality of existing services. In this respect, Verizon's interest in appropriate antitrust rules for restraints ancillary to legitimate productive

cooperation is similar in kind to the interest of countless other businesses in all sectors of the economy. Verizon's interest differs in degree, however, because productive cooperation is especially common and useful in the telecommunications industry.

For example, high-risk investments that require large amounts of capital are often undertaken through joint ventures or other cooperative arrangements. Cooperation between potential competitors played a major role in the deployment of transoceanic fiber optic cables to carry telephone and internet traffic between the United States and Europe, Asia, South America, and other parts of the world. See, *e.g.*, David O. Williams, *An Oversimplified Overview of Undersea Cable Systems* 10 (2000), http://davidw.home.cern.ch/davidw/public/SubCables.html.

Cooperative arrangements are also commonly used for research and development projects, where they allow the partners to share costs and risks, and also bring together the partners' complementary skills and knowledge. Consumers of telecommunications services often have communications needs that extend beyond the boundaries of any single carrier's network. Joint ventures and other cooperative arrangements have been a valuable mechanism for serving such customers. For example, MCI partnered with British Telecom to provide complex services to multinational corporations with facilities throughout the world. *Request of MCI Communications Corp. & British Telecommunications PLC*, 9 FCCR 3960 (1994). Sprint entered into a similar arrangement with France Telecom and Deutsche Telekom. *Sprint Corp.*, 11 FCCR 1850 (1996). AT&T partnered with telecommunications carriers from other European and Asian countries. *Id.* ¶ 86. In theory, a multinational corporation could contract separately with MCI for services in the United States and with British Telecom for services in the United Kingdom. Such an arrangement, though, would require the customer to solve the complex problem of ensuring integration and compatibility between its telecommunications systems in the United States and in the United Kingdom. The joint ventures provided a mechanism through which the telecommunications carriers themselves could address that complex problem for the customer's benefit. *Id.* ¶¶ 84-87.

The importance of coordination and standard setting motivated the creation of another joint venture, Bellcore, in connec-

tion with the breakup of AT&T pursuant to an antitrust decree. That joint venture, financed and controlled by the seven regional Bell companies, was created to "perform the coordination for national defense and other emergency purposes that is vital to the nation's security" and to "set the standards which will permit telecommunications to continue to operate in an engineering sense as one national network." *United States* v. *Western Elec. Co.*, 569 F. Supp. 1057, 1118 (D.D.C. 1983). The decree court explained, "It seems beyond debate that uniform standards are necessary to ensure high quality in the telephone system, indeed its very survival as a nationwide network. Nor are such standards incompatible with competition." *Id.* at 1116 (footnote omitted).

The commission of error in the decision below is clear enough from this Court's prior decisions, but Verizon urges this Court to do more than simply reiterate the principles that were stated clearly in those decisions. By laying down a simple, *general* principle to distinguish "naked" restraints subject to the *per se* rule from "ancillary" restraints subject to the rule of reason, the Court can do much to remove a cloud of antitrust fear from *productive* cooperative activity that benefits American businesses and consumers alike.

For the foregoing reasons, Verizon's brief can present this Court with both a practical perspective and a legal argument that may not be fully covered by other briefs in this case. Verizon's motion to file the accompanying brief as *amicus curiae* in support of petitioners should be granted.

Respectfully submitted.

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BRIEF OF VERIZON COMMUNICATIONS INC. AS *AMICUS CURIAE* SUPPORTING PETITIONERS

INTEREST OF THE *AMICUS CURIAE*[1]

The interest of the *amicus curiae* is described in the accompanying motion for leave to file this brief.

INTRODUCTION AND SUMMARY OF ARGUMENT

Petitioners have powerful arguments in this case that Section 1 of the Sherman Act has no applicability at all because the challenged activity is simply a *single firm's* – Equilon's – setting of its own prices. Even if the Court determines or assumes that the challenged activity should be treated as an agreement between Texaco and Shell, and that those firms are competitors rather than businesses that have exited the relevant market, however, it is both easy and important to reject application of the *per se* rule.

The boundary line between practices condemned *per se* and those subject to the rule of reason has enormous practical consequences for antitrust litigation. See 7 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1511a, at 418-419 (2d ed. 2003); see also 2 *id.* ¶ 303b2, at 29-31 (2d ed. 2000). More specifically, if Section 1 applies at all, this case raises the question whether all practices that *literally* may be described using the labels of hardcore antitrust offenses – such as "price fixing" or "market allocation" – must be summarily condemned under the *per se* rule. The answer is no: such practices, when ancillary to productive, output-expanding activity, should be evaluated under a properly structured rule of reason, which permits consideration of the myriad ways such practices may be beneficial to competition.

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[1] Under Rule 37.6 of the Rules of this Court, *amicus curiae* states that no counsel for a party has written this brief in whole or in part and that no person or entity other than the *amicus curiae* or its counsel has made a monetary contribution to the preparation or submission of this brief.

That is true even if the ancillary restraint is the product of an agreement between actual or potential competitors, and regardless of whether the parties' cooperative efforts are undertaken through a distinct legal entity (*e.g.*, a corporation or partnership) that is owned and managed by the cooperating firms, or separately by each of the businesses involved, pursuant to contractual arrangements. The true test of ancillarity – which was explained particularly well by Judge Easterbrook in *Polk Bros., Inc.* v. *Forest City Enterprises, Inc.*, 776 F.2d 185 (7th Cir. 1985), and by Judge Bork in *Rothery Storage & Van Co.* v. *Atlas Van Lines, Inc.*, 792 F.2d 210 (D.C. Cir. 1986) – does not turn on such facts, but rather on "whether an agreement promoted enterprise and productivity at the time it was adopted. If it arguably did, then the court must apply the Rule of Reason to make a more discriminating assessment." *Polk Bros.*, 776 F.2d at 189. Agreements *legitimately* curtailing competition between the parties to cooperative arrangements arise in many settings, because businesses cooperating with one another must find ways to ensure that each will devote its wholehearted efforts to their mutual endeavor. As Professor Hovenkamp, Judge Bork, and Judge Easterbrook have all cogently explained, antitrust rules should protect such output-expanding cooperation.

Application of the *per se* rule to restraints accompanying such cooperation is dangerous, and conflicts with this Court's precedents. Time and again this Court has rejected efforts to pigeonhole ancillary restraints into the categories that experience has shown to be almost always anticompetitive. To say that a practice is literally "price fixing" or "market allocation," when it is ancillary to an output-expanding form of cooperation, is to substitute labels for antitrust experience and substance.

Extensive experience, in fact, has shown how benign ancillary restraints can be, and how little need there is for a *per se* rule to condemn *any* restraints ancillary to output-expanding cooperation. Economists and the antitrust enforcement agencies have reached a strong consensus that *per se* treatment is inappropriate. And the rule of reason can be applied in a

structured way to evaluate ancillary restraints, condemning those are truly anticompetitive but not creating a morass of uncertainty that will result in costly and unpredictable litigation and deter beneficial conduct because the outcome of antitrust litigation cannot be confidently forecasted. The *per se* rule is not needed to protect against false negatives, but it is sure to yield false positives in cases like this one.

Petitioners and *amici* have correctly identified numerous features of Equilon and the "price-fixing" agreement in this case that make it a particularly poor candidate for *per se* treatment, but the Court should not write an opinion as if only those particular characteristics can take a case outside the *per se* rule. Rather, if Section 1 applies at all, the issue of *per se* or rule-of-reason treatment should turn on a simpler and more fundamental question: Could the restraint plausibly contribute to the successful operation of an output-expanding cooperative arrangement? If the answer to that question is yes, the restraint cannot be condemned as *per se* illegal. It is especially misguided to apply *per se* rules if an expert government agency has carefully reviewed and blessed an ancillary restraint – a point the Ninth Circuit was quite wrong to ignore, in light of the FTC's review of the formation of Equilon. If an antitrust defendant asserts plausibly that an agreement could contribute to the successful operation of an output-expanding cooperative arrangement, that defense should be considered on its merits, not summarily rejected on the basis of formalistic distinctions.

ARGUMENT

I. Antitrust Rules Should Protect Output-Expanding Cooperation Even Among Firms That Might Otherwise Compete

"Cooperation is the basis of productivity. * * * Joint ventures, mergers, systems of distribution – all these and more require extensive cooperation * * *." *Polk Bros.*, 776 F.2d at 188. It is thus immediately apparent that the kinds of cooperation that *potentially* benefit consumers include, but are by no means limited to, traditional joint ventures such as Equilon, a

business entity separate from its parents. Beneficial cooperative arrangements range from simple contracts through formal joint ventures through full merger, with legitimate economic factors determining the choice among those forms of cooperation. See Howard Chang, David Evans & Richard Schmalensee, *Some Economic Principles For Guiding Antitrust Policy Towards Joint Ventures*, 1998 COLUM. BUS. L. REV. 223, 239 ("Beginning with Coase's classic work on the nature of the firm, economists and legal scholars have recognized that the scope of a firm is determined, in part, by the relative advantages of conducting business through informal contracts between factors of production within the firm and employing formal contracts to link separate firms.") (citing Ronald H. Coase, *The Nature of the Firm*, in RONALD H. COASE, THE FIRM, THE MARKET, AND THE LAW 33 (1990)).

Cooperation between *competitors* can be particularly beneficial in expanding output. Through such cooperation, businesses can make investments that would be too costly or too risky for a single firm to undertake; achieve economies of scale; combine complementary knowledge and skills (*e.g.*, in research and development projects); and establish uniform standards that make their products more useful and valuable to consumers. A company may seek to partner with a competitor to undertake virtually any business activity, including research and development, manufacturing, distribution, and marketing. The partners might form a joint venture with virtually complete autonomy from its parents, keep nearly complete control over the cooperative arrangement, or establish any form of entity with any intermediate degree of autonomy that the parents choose to confer; they can enter into arrangements for a narrow purpose and for a short duration, or for broad and open-ended purposes and for a permanent or indefinite duration. It is largely because of this flexibility that joint ventures and other cooperative arrangements hold out such promise for productive business activity.

A company that is considering whether to participate in a cooperative arrangement will, of course, consider the costs and

benefits of the alternatives. The principal alternatives are usually (1) acting unilaterally, rather than through a cooperative arrangement, and (2) a merger or acquisition that would unify the potential partners in a single firm. In many cases, both alternatives will be inadequate to achieve a company's business objectives and, more important, may be less beneficial to competition than a cooperative arrangement would be. A unilateral effort may not be feasible at all or may entail significantly greater costs or achieve less desirable results; the unattractiveness of that alternative is usually the reason that a partner is sought in the first place. A merger, likewise, may not be feasible for many reasons, and in any event will permanently and entirely eliminate competition between the potential partners. Nevertheless, companies may be forced to choose one of these suboptimal options if they are unable to achieve a satisfactory solution to a serious problem that often confronts cooperative arrangements: that the partners may have divergent interests that interfere with effective cooperation or that prevent the partners from devoting their wholehearted efforts to their mutual endeavor. See Chang et al., *supra,* 1998 COLUM. BUS. L. REV. at 243-249.

The most effective way to ensure that the partners' interests are aligned will often be to limit the degree to which they compete against each other and against any jointly owned business they may create, and to structure the arrangement so that each partner is appropriately rewarded for participation and investment in the cooperative effort. See 13 HERBERT HOVENKAMP, ANTITRUST LAW ¶2131, at 166-175 (2d ed. 2005) (discussing restraints to address free-rider problems and to create incentives for investment in a joint venture). Such arrangements have the purpose and effect of limiting the partners' competition *with each other* – not surprisingly, since cooperation between the partners is the essence of every business contract – and, because of that characteristic, they have sometimes raised antitrust concerns. In the vast majority of these arrangements, however, restrictions on the partners' competition with each other are an important component of

arrangements that allow the partners to achieve efficiencies that enhance competition against other market participants.

Accordingly, leading commentators have recognized that restraints may be ancillary – and thus subject to the rule of reason rather than the *per se* rule – to both joint ventures and other forms of cooperation between actual or potential competitors. Compare 11 HERBERT HOVENKAMP, ANTITRUST LAW ¶ 1908b (2d ed. 2005) (discussing restraints ancillary to "presumptively efficient joint venture or other transaction") with *id.* ¶ 1908c (discussing restraints ancillary to "lawful transfers of property rights, licenses, hiring agreements, dissolutions, and settlements"). "The integration of economic activities, which is indispensable to productive efficiency, always involves the implicit elimination of actual or potential competition. We allow it – indeed, should encourage it – because the integration creates wealth for the community. We should equally encourage those explicit and ancillary agreed-upon eliminations of rivalry that make the basic integration more efficient." ROBERT H. BORK, THE ANTITRUST PARADOX 28 (1978).

This Court too has recognized that restraints may be ancillary – and thus not treated as "naked" – to any transaction or relationship:

> The classic "ancillary" restraint is an agreement by the seller of a business not to compete within the market. See *Mitchel* v. *Reynolds*, 1 P. Wms. 181, 24 Eng. Rep. 347 (1711); Restatement (Second) of Contracts § 188(2)(a) (1981). That is not ancillary to any other contractual obligation, but, like the restraint here, merely enhances the value of the contract, or permits the "enjoyment of [its] fruits." *United States* v. *Addyston Pipe & Steel Co.*, 85 F. 271, 282 (CA6 1898), aff'd, 175 U. S. 211 (1899); cf. Restatement (Second) of Contracts §§ 187, 188 (1981) (restraint may be ancillary to a "transaction or *relationship*") (emphasis added); R. Bork, The Antitrust Paradox 29 (1978) * * * (vertical arrangements are ancillary to the "transaction of supplying and purchasing").

Business Electronics Corp. v. *Sharp Electronics Corp.*, 485 U.S. 717, 729 n.3 (1988).

The Federal Trade Commission has accurately observed that "[n]o analytical exercise is more important to U.S. competition policy than defining the bounds of acceptable cooperation between direct rivals." *Polygram Holding, Inc.*, Docket No. 9298 (FTC), http://www.ftc.gov/os/2003/07/polygramopinion.pdf, at 2 (2003), aff'd, 416 F.3d 29 (D.C. Cir. 2005). A key feature of that analytical exercise is to distinguish output-expanding from output-limiting cooperation.

> Determining whether a restraint is ancillary is simply a way of deciding whether it can be condemned as illegal "per se," or upon a relatively quick look; or whether a more complete analysis of the market and likely competitive effects is essential. In performing this analysis we must always keep two underlying questions in focus. *First*, the antitrust tribunal wishes to know whether the overall impact of the restraint is to reduce output, thus injuring consumers, or to expand output and benefit them. *Second*, the litigation process is costly and its ability to analyze complex, contested issues and produce accurate results is limited. As a result, simplifying assumptions are necessary.

11 HOVENKAMP, *supra*, ¶ 1908, at 251-252 (footnotes omitted).

The most successful judicial efforts to date to take stock of these basic points were, we submit, Judge Easterbrook's opinion for the court in *Polk Bros., Inc.* v. *Forest City Enterprises, Inc.*, *supra* and Judge Bork's opinion for the court in *Rothery Storage & Van Co.* v. *Atlas Van Lines, Inc.*, *supra*. Like this Court in this case, the Seventh Circuit in *Polk Bros.* was reviewing the decision of a lower court that had subjected to the *per se* rule a restraint eliminating competition between two partners to a productive business arrangement. In *Polk Bros.* the restraint was a non-competition agreement (or "market allocation") whereas in this case it is an agreement regulating price (or "price fixing"), but in each case it was an agreement of a sort that – if

"naked" – could be condemned *per se*.[2] In *Polk Bros.* the cooperative arrangement to which the restraint was ancillary was a contractual arrangement to build a shopping mall whereas in this case it is a separate business entity formed as a joint venture. As Judge Easterbrook correctly understood, however, the particular restraint at issue, and the particular form of cooperative arrangement to which it is ancillary, are not the relevant questions:

> Antitrust law is designed to ensure an appropriate blend of cooperation and competition, not to require all economic actors to compete full tilt at every moment. When cooperation contributes to productivity through integration of efforts, the Rule of Reason is the norm.
>
> A court must distinguish between "naked" restraints, those in which the restriction on competition is unaccompanied by new production or products, and "ancillary" restraints, those that are part of a larger endeavor whose success they promote. If two people meet one day and decide not to compete, the restraint is "naked"; it does nothing but suppress competition. If A hires B as a salesman and passes customer lists to B, then B's reciprocal covenant not to compete with A is "ancillary." * * *
>
> The evaluation of ancillary restraints under the Rule of Reason does not imply that ancillary agreements are not real

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[2] For purposes of this discussion we *assume* that the price setting at issue should be treated as an agreement between Shell and Texaco rather than as single-firm conduct, and that Shell and Texaco should be treated as competitors despite the total exit of both from the relevant market on the formation of Equilon. As noted earlier, we acknowledge, and in no way wish to contradict, petitioners' powerful arguments that it should be treated as a joint venture's pricing of its own products and not subject to Section 1 of the Sherman Act at all, or as an agreement by non-competitors. But we also make the fundamental point that the price setting cannot possibly be condemned *per se* even on the assumption that it should be treated as an agreement between competitors.

horizontal restraints. They are. * * * The difference comes at the time people enter beneficial arrangements. * * *

A court must ask whether an agreement promoted enterprise and productivity at the time it was adopted. If it arguably did, then the court must apply the Rule of Reason to make a more discriminating assessment. * * *

A restraint is ancillary when it may contribute to the success of a cooperative venture that promises greater productivity and output. If the restraint, viewed at the time it was adopted, may promote the success of this more extensive cooperation, then the court must scrutinize things carefully under the Rule of Reason. * * *

* * * * *

The reason for distinguishing between "ancillary" and "naked" restraints is to determine whether the agreement is part of a cooperative venture with prospects for increasing output. If it is, it should not be condemned *per se.*

776 F.2d at 188-190 (citations omitted).

The D.C. Circuit emphasized the same points in *Rothery*:

All horizontal restraints are alike in that they eliminate some degree of rivalry between persons or firms who are actual or potential competitors. * * * The difficulty [with a rule treating such restraints as *per se* illegal] was that such a rule could not be enforced consistently because it would have meant the outlawing of very normal agreements (such as that of law partners not to practice law outside the firm) that obviously contributed to economic efficiency. The alternative formulation was that of Judge Taft in *Addyston Pipe & Steel*: a naked horizontal restraint, one that does not accompany a contract integration, can have no purpose other than restricting output and raising prices, and so is illegal *per se*; an ancillary horizontal restraint, one that is part of an integration of the economic activities of the parties and appears capable of enhancing the group's

> efficiency, is to be judged according to its purpose and effect.

792 F.2d at 229.

This reasoning is compelling, particularly when one recalls that classification of a restraint as "ancillary" has one, and only one, consequence: the classification permits the court to *consider a practice's market effects, including (if necessary) its justifications* – rather than cut off inquiry as the *per se* rule does – when deciding whether the restraint promotes competition and expands output, or unreasonably restricts competition and limits output. The rule of reason produces both judgments for plaintiffs and judgments for defendants, but it permits *informed* judgments.

The alternative is to misclassify restraints that are *not* of the sort that "considerable experience" shows to be almost always anticompetitive, *Broadcast Music, Inc.* v. *Columbia Broadcasting System, Inc.*, 441 U.S. 1, 2 (1979), as if they were the same as the traditional *per se* categories such as "price fixing" and "market allocation." It is to substitute a jurisprudence of labels for one of substance. That is decidedly *not* what this Court's cases – or the logic of antitrust law – require, with respect to joint ventures or any other form of cooperative arrangement.

II. Under *BMI*, *NCAA*, and *Northwest Wholesale Stationers*, Restraints Associated With Legitimate Cooperative Arrangements Are Not Subject To *Per Se* Condemnation

Per se rules of illegality have been exceptional in the interpretation and application of the Sherman Act throughout its history. Early on this Court recognized that the Sherman Act could not be construed to prohibit every restraint of trade without prohibiting *every* commercial agreement, because "[e]very agreement concerning trade, every regulation of trade, restrains. To bind, to restrain, is of their very essence." *Bd. of Trade of Chicago* v. *United States*, 246 U.S. 231, 238 (1918). Congress plainly did not intend to prohibit every agreement that restricts competition; "Congress intended to outlaw only

unreasonable restraints." *State Oil Co.* v. *Khan*, 522 U.S. 3, 10 (1997) (emphasis added). A "rule of reason," appropriately defined and structured, has thus been "the prevailing standard of analysis" of restraints challenged under the Sherman Act. *Continental T.V., Inc.* v. *GTE Sylvania, Inc.*, 433 U.S. 36, 49 (1977); see *California Dental Ass'n* v. *FTC*, 526 U.S.756, 781 (1999).

However, some kinds of restraints, including "price fixing" among would-be rivals, are subject to a "conclusive presumption" of unreasonableness and are condemned as illegal *per se*. *Arizona* v. *Maricopa County Medical Society*, 457 U.S. 332, 345 (1982). That *per se* rule, where it applies, severely limits the defenses that a defendant may proffer and that a court or jury may consider. It is irrelevant whether the agreed-upon prices are reasonable. See, *e.g.*, *FTC* v. *Superior Court Trial Lawyers Ass'n*, 493 U.S. 411, 424 (1990). It is irrelevant whether the defendants had the ability to raise market prices above competitive levels (*i.e.*, whether they possessed "market power"). See, *e.g.*, *United States* v. *Socony-Vacuum Oil Co.*, 310 U.S. 150, 225-226 n.59 (1940). The actual market effects of the agreement are irrelevant and need not be proved. *Id.* at 225.

Because it severely limits the ability of courts to consider whether a particular restraint may be beneficial, rather than harmful, the *per se* rule is a dangerous weapon in the hands of private plaintiffs, who naturally seek to protect their own commercial interests, whether or not the public interest is served. The dangers are especially severe when the rule is invoked to challenge efforts by competing firms to cooperate in order to achieve efficiencies. Three landmark decisions protect against that danger.

Broadcast Music, Inc. v. *Columbia Broadcasting System, Inc.*, 441 U.S. 1 (1979) (*BMI*), involved an antitrust challenge to "blanket licenses" offered by BMI and ASCAP, organizations that were formed to represent the interests of thousands of independent copyright owners. The blanket licenses permitted

licensees to pay a single fee to BMI or to ASCAP for the right to use any of the copyrighted music in their respective portfolios. *BMI* held that this arrangement was not a *per se* violation, but did not decide whether it would be illegal under a rule-of-reason analysis.

NCAA v. *Board of Regents*, 468 U.S. 85 (1984), examined restrictions on the number of NCAA football games that could be offered for television broadcasts. Although it recognized that "[r]estrictions on price and output are the paradigmatic examples of restraints of trade that the Sherman Act was intended to prohibit," *id.* at 107-108, the Court held that the *per se* rule did not govern analysis of this restraint, because some degree of cooperation by the NCAA's members, rather than unrestrained competition, served to "widen consumer choice." *Id.* at 102. The restraint therefore was evaluated under the rule of reason, but was found to be illegal.

Northwest Wholesale Stationers, Inc. v. *Pacific Stationery & Printing Co.*, 472 U.S. 284 (1985), involved a purchasing cooperative formed by independent office supply retailers to reduce their costs of procuring office supplies for resale. Pacific was expelled by the cooperative and then sued, alleging that the expulsion was a "group boycott" that was illegal *per se*. The Court held that the *per se* rule against boycotts did not apply, and remanded the case for evaluation under the rule of reason.

The common thread in all three cases was that the defendants' activities were integrated in ways that offered the potential to achieve significant efficiencies. In *BMI*, the blanket license obviated individual negotiations with thousands of copyright owners, resulting in a "substantial lowering of costs." 441 U.S. at 21. In *NCAA*, even though the NCAA acted to limit its members' activities in myriad ways, "the great majority of the NCAA's regulations enhance competition." 468 U.S. at 103. In *Northwest Wholesale Stationers*, the formation of the purchasing cooperative was "'designed to increase economic efficiency and render markets more, rather than less, competitive.'" 472 U.S. at 295 (quoting *BMI*, 441 U.S. at 20).

In each case, the context of the restraint – not the fact that some form of competition was literally restrained – was decisive, because restraints associated with efficiency-enhancing integration or output-expanding cooperation lack the basic characteristic required for application of a *per se* rule: They do not "always or almost always tend to restrict competition and decrease output." *BMI*, 441 U.S. at 20-21. "[D]eparture from the rule of reason standard must be based upon demonstrable economic effect rather than * * * upon formalistic line drawing." *GTE Sylvania*, 433 U.S. at 58-59. An "overly simplistic and often overbroad" approach that asks whether "two or more potential competitors have literally 'fixed' a 'price,'" *BMI*, 441 U.S. at 9, cannot reliably determine whether restraints associated with a cooperative arrangement will have such effects because restraints on competition between partners often contribute to the cooperative arrangement's legitimate and procompetitive operations. To illustrate that point, the Court in *BMI* gave as an example precisely the situation alleged in this case: "When two partners set the price of their goods or services they are literally 'price fixing' but they are not *per se* in violation of the Sherman Act." *Ibid.* When restraints are adopted in the context of an output-expanding cooperative arrangement, "[a] fair evaluation of their competitive character requires consideration of the * * * justifications for the restraints" even if the restraint directly limits participants' freedom "to compete in terms of price and output." *NCAA*, 468 U.S. at 103.

That principle follows from the fundamental rationale for the *per se* rule, which is explicitly grounded on a cost/benefit analysis. *Per se* rules entail a cost of error, because a court cannot even consider potential justifications for the restraint or its effects in a particular market context. Balanced against that cost of error is a potential benefit, because the *per se* rule eliminates the cost of litigation concerning the justifications and effects of the restraint. As the Chief Judge of the D.C. Circuit (and former Assistant Attorney General for the Antitrust Division) explained recently:

> *Per se* analysis, which requires courts to generalize about the utility of a challenged practice, reduces the cost of decision-making but correspondingly raises the total cost of error by making it more likely some practices will be held unlawful in circumstances where they are harmless or even procompetitive * * * The converse – increased litigation cost but reduced cost of error – obtains under the rule of reason, which requires an exhaustive inquiry into all the myriad factors bearing on whether the conduct is on balance anticompetitive or procompetitive.

Polygram Holding, Inc. v. *FTC*, 416 F.3d 29, 34 (D.C. Cir. 2005) (internal quotations and citations omitted).

This Court has emphasized time after time that the benefits outweigh the costs *only* if *per se* condemnation is reserved for restraints that are "manifestly anticompetitive." *GTE Sylvania*, 433 U.S. at 49-50. The only restraints that warrant the *per se* label are those that have "predictable and pernicious anticompetitive effect, and * * * limited potential for procompetitive benefit." *Khan*, 522 U.S. at 10 (citing *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958)). Restraints that plausibly enable a cooperative arrangement to operate more effectively – whether or not they are "essential" to the venture – do not satisfy that standard. See *Polk Bros.*, 776 F.2d at 189 (emphasis added) ("A restraint is ancillary when it *may* contribute to the success of a cooperative venture that promises greater productivity and output."). In this setting, "the conclusion that [a restraint] is virtually always likely to have an anticompetitive effect is not warranted." *Northwest Wholesale Stationers*, 472 U.S. at 296; accord *BMI*, 441 U.S. at 20-21 (restraint that "accompanies the integration of sales, monitoring, and enforcement against unauthorized copyright use" cannot be deemed a restraint that "always or almost always tend[s] to restrict competition and decrease output"); see also *Business Electronics*, 485 U.S. at 729 (rejecting the dissent's "naked restraint" analysis and instead treating the agreement as "ancillary" because "[a] quite plausible purpose of the restriction [is] to enable Hartwell to provide better services" under the sales agreement).

III. Experience Has Confirmed That The Cost Of Applying *Per Se* Rules To Restraints Ancillary To Output-Expanding Cooperative Arrangements Would Exceed The Benefits

The clarity with which this Court has laid down rules inconsistent with the Ninth Circuit's holding below led the Solicitor General, in response to this Court's invitation, to suggest summary reversal. U.S. Br. 19 (filed May 26, 2005). We agree wholeheartedly that the Ninth Circuit's decision must be reversed under existing precedents.[3] To the extent there is any question, however, of taking a fresh look at those precedents, we respectfully submit that experience counsels that the Court should confirm and reinforce the strong movement, in lower court decisions and agency actions, toward *more*, not less, hospitable treatment of restraints that accompany efficiency-enhancing cooperative arrangements.

Considerable experience with restraints ancillary to cooperative arrangements has demonstrated overwhelmingly that such restraints are not always, almost always, or even usually anticompetitive. The lesson to be drawn from more than two decades of experience applying the rule of reason under *BMI*, *NCAA*, and *Northwest Wholesale Stationers* is exactly the opposite. If there was any doubt two decades ago concerning the costs and benefits of applying the rule of reason to such restraints, those doubts have been erased by experience. Two developments, in particular, provide strong support for continuing to examine such restraints under the rule of reason.

1. First, in the years since *BMI*, *NCAA*, and *Northwest Wholesale Stationers* made clear that restraints ancillary to output-expanding cooperative arrangements should not be summarily condemned, lower courts have examined an extraordinary number and variety of such restraints under the

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[3] The U.S. Chamber of Commerce, the American Bankers Association, and other *amici* also believe that the Ninth Circuit erred in applying a *per se* analysis.

rule of reason. As *Polk Bros.* and *Rothery* illustrate, when courts have evaluated the *actual* competitive effects of these restraints, they frequently have found that the restraints are procompetitive, rather than harmful to consumers. See also Brief for Visa U.S.A. Inc., et al. Supporting Petitioners (to be filed Sept. 12, 2005).

The antitrust agencies, likewise, have concluded that ancillary restraints often serve a legitimate purpose by promoting effective cooperation in output-enhancing collaborations. The agencies have issued guidelines to make clear that such restraints are often beneficial and to describe the specific and limited circumstances in which they may pose a threat to competition. FTC & Department of Justice Antitrust Division, *Antitrust Guidelines for Collaborations Among Competitors* (2000), http://www.ftc.gov/os/2000/04/ftcdojguidelines.pdf. The agencies have emphasized, consistent with the lower courts' experience, that competitors' cooperative arrangements "often are not only benign but procompetitive. Indeed, in the last two decades the federal antitrust agencies have brought relatively few civil cases against competitor collaborations." *Id.* at 1.[4]

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[4] The agencies' Collaboration Guidelines followed several years of empirical study including two months of public hearings at the Federal Trade Commission. A report following the hearings concluded that "[g]lobal and innovation-based competition is driving firms toward ever more complex collaborative agreements. Collaborations among rivals raise many new and complex competitive issues * * * Witnesses at the hearings agreed that antitrust treatment of collaborations among rivals is an important issue in need of clarification." 1 FEDERAL TRADE COMMISSION, ANTICIPATING THE 21ST CENTURY: COMPETITION POLICY IN THE NEW HIGH-TECH, GLOBAL MARKETPLACE, ch. 10, at 1 (May 1996). "Collaborations among rivals can generate significant efficiency gains. By bringing the abilities and resources of several companies together, collaborating firms may attain economies of scale and scope; increase capacity and market access; minimize risk; avoid duplication; transfer, commercialize, or distribute technology efficiently; combine complementary or co-specialized capabilities; or better appropriate the returns of innovation. Such benefits, or efficiencies, can speed the development of new products, lead to better products, reduce the costs of

Scholars and other commentators overwhelmingly support the view that such restraints often promote efficiency and competition. There is continuing debate about the subtleties of analyzing such restraints under the rule of reason; there is virtually no debate that the rule of reason, rather than *per se* analysis, should govern. See, *e.g.*, Chang et al., *supra*, 1998 COLUM. BUS. L. REV. at 301 (describing divergent proposals for rule-of-reason analysis but noting consensus that ancillary restraints should be treated under the rule of reason); Edward Correia, *Joint Ventures: Issues in Enforcement Policy*, 66 ANTITRUST L.J. 737, 753-755 & nn.70-71 (1998).

2. The cost/benefit calculation underlying *per se* rules should also take account of changes over the past two decades in litigation under the rule of reason. The principal benefit of the *per se* rule – avoiding the cost of protracted litigation under the rule of reason – is somewhat illusory because rule-of-reason litigation is less of a morass than it once was, and need not be a morass at all if properly structured.

In 1982, in *Maricopa*, this Court correctly observed that *per se* rules "avoid 'the necessity for an incredibly complicated and prolonged economic investigation into the entire history of the industry involved, as well as related industries, in an effort to determine at large whether a particular restraint has been unreasonable – an inquiry so often wholly fruitless when undertaken.'" 457 U.S. at 351 (quoting *Northern Pac. Ry.* v. *United States*, 356 U.S. 1, 5 (1958)). At that time, the rule of reason was rightly derided as a mode of analysis in which "everything is relevant, nothing is dispositive." Frank H. Easterbrook, *The Limits Of Antitrust*, 63 TEX. L. REV. 1, 12 (1984).

That was true then, but is not widely true today and this Court should make clear authoritatively that it should not be true. "[T]he questions that the rule of reason considers can generally be answered with a far less elaborate and more

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product development, and enhance interoperability in a particular industry." *Id.* ch. 10 at 2 (footnotes omitted).

focused inquiry than Justice Brandeis [in *Chicago Board of Trade*] had in mind." 13 HOVENKAMP, *supra*, ¶ 2100g, at 17. In large measure because substantive antitrust doctrine has been refined and clarified, rule-of-reason cases need not be incredibly complicated and prolonged. Many can be resolved without "'elaborate industry analysis.'" *NCAA*, 468 U.S. at 109 (quoting *Nat'l Soc'y of Prof'l Eng'rs* v. *United States*, 435 U.S. 679, 692 (1978)). All that is required is "an enquiry meet for the case, looking to the circumstances, details, and logic of a restraint." *California Dental Ass'n*, 526 U.S. at 781. The "most condensed" rule of reason analysis may be conducted in "the twinkling of an eye." *Id.* at 780 (quoting PHILLIP E. AREEDA, ANTITRUST LAW ¶ 1507, at 402 (1986)). Some restraints require a bit more – the kind of analysis that has been described as a "quick look" – and others require a "less quick look." *Id.* at 781. And some, but certainly not all, require "the fullest market analysis" or a "plenary market examination." *Id.* at 779.

Properly structured, rule-of-reason analysis need not and should not be a morass. Courts can adopt screens or presumptions – such as those suggested by Judge Easterbrook in 1984,[5] or those suggested in more recent scholarship that builds on

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[5] Easterbrook, *supra*, 63 TEX. L. REV. at 17-18. According to Judge Easterbrook, first the plaintiff should be required to show that the defendants have market power – a screen the plaintiffs in this case would fail. Second, the plaintiff should be required to show that the defendant has an incentive to behave in an anticompetitive way and that antitrust sanctions are necessary to correct the defendant's incentives. Third, the court should ascertain whether firms in the industry use different methods of production and distribution. Fourth, the court should ask whether the evidence is consistent with a reduction in output. Fifth, the court should use the identity of the plaintiff to draw inferences about the competitive effects of the challenged conduct, recognizing that rivals are most likely to challenge conduct harmful to them but beneficial to consumers. "Only when a potentially-efficient business practice passes all five filters should a court undertake the heroic efforts required by today's Rule of Reason." *Id.* at 18.

Judge Easterbrook's original insights[6] – to make application of the rule of reason both practical and predictable. Otherwise, antitrust litigation becomes a lottery in which lay juries are asked to decide economic questions that trained economists find surpassingly difficult. And, even worse, if rule-of-reason analysis is unstructured, businesses are deterred from beneficial cooperation because no competent counselor can assure them that a particular practice that has both clear pro-consumer benefits and arguable countervailing negative effects on competition will survive the courts' indeterminate inquiry.

Because it is clear today (even though it was not clear when *BMI* and *NCAA* were decided) that rule-of-reason litigation can and should be conducted efficiently, there is far less reason to tolerate the cost of error that inevitably flows from *per se* rules. Indeed, there is reason to suspect today that an antitrust plaintiff – like respondents, see U.S. Br. 16 & n.17 (filed May 26, 2005) – who is unwilling even to attempt to prove liability under a

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[6] See, *e.g.*, David S. Evans & A. Jorge Padilla, *Designing Antitrust Rules for Assessing Unilateral Practices: A Neo-Chicago Approach*, 72 U. CHI. L. REV. 73 (2005). Professor Evans and Dr. Padilla note that Judge Easterbrook in 1984 "emphasized the importance of presumption in structuring antitrust inquiries" and "observed that the full rule of reason approach is often impractical." Commenting on what economists have learned since the Easterbrook article was published, they state that, with "the benefit of over twenty years of game-theoretic industrial organization models * * *, [we are] skeptical about the ability of economics to provide the necessary guidance for a full-blown rule of reason inquiry." *Id.* at 75 n.8. Accordingly, they suggest three presumptions about unilateral practices. *Id.* at 81. Because the present case is brought (rightly or wrongly) under Section 1 of the Sherman Act, which does not address unilateral practices, the details of these scholars' proposed presumptions are not especially relevant to the Court's decision. What *is* relevant, however, is their larger point that experience and scholarship have demonstrated the need to avoid both blindered condemnation (under the *per se* rule) of practices with procompetitive justification, and formless rule-of-reason inquiry that produces no predictable outcomes and therefore deters beneficial conduct because no one can be sure it will not be condemned.

rule-of-reason analysis is merely trying to exploit that risk of error.

IV. Restraints That Plausibly Could Contribute To The Success Of A Legitimate, Output-Expanding Cooperative Arrangement Should Be Evaluated Under A Properly Structured Rule Of Reason

1. Petitioners and *amici* have argued that the application of a *per se* rule is particularly inappropriate because of the specific characteristics of the pricing decision challenged in this case. They argue, for example, that the pricing decision here should be regarded as single-firm conduct that is not subject to Section 1 of the Sherman Act, *e.g.*, Texaco Pet. 10-12; that it is an absolute necessity to establish prices for a joint venture's products, *e.g.*, Shell Pet. 12; that the restraint concerned only the joint venture's activities, not parents' activities outside of the joint venture, *e.g.*, U.S. Br. 15-16 (filed May 26, 2005); and that, after formation of the joint venture, its parents were no longer competitors (because all of their assets and operations in the relevant market were transferred to the joint venture), *e.g.*, *id.* at 8-9, 11. We agree that the practice challenged in this case could not have unreasonably restricted competition in light of those characteristics.

The establishment of a Section 1 "restraint" between two separate actors is of course a threshold condition even to be considering possible *per se* condemnation. But that obvious requirement aside, the Court will needlessly discourage desirable cooperative arrangements if it suggests that any of these specific characteristics of *this* restraint are required to ensure rule-of-reason analysis. The issue of *per se* or rule-of-reason treatment should turn on a simpler and more fundamental question: Could the restraint plausibly contribute to the successful operation of an output-expanding cooperative arrangement? If the answer to that question is yes, the restraint cannot be condemned as *per se* illegal.

This principle will preserve *per se* analysis for "price-fixing" agreements (and other *per se* offenses) if a joint venture

or other cooperative arrangement is a sham that involves no meaningful integration of the parties' businesses or other output-expanding cooperation. It would also preserve *per se* analysis if the cooperative arrangement itself is legitimate, but if the "price fixing" is unrelated to the joint venture's legitimate activities. See U.S. Br. 13 n.12 (filed May 26, 2005). But it would ensure rule-of-reason analysis for any restraint that plausibly could contribute to the successful operation of an efficiency-enhancing integration. See 7 AREEDA & HOVENKAMP, *supra*, ¶ 1511c, at 420-421. See generally Easterbrook, *supra*, 63 TEX. L. REV. at 5 ("The inhospitality tradition of antitrust has proven very costly. The costs were inevitable. Wisdom lags far behind the market.").

Satisfaction of this standard does not establish that any restraint is lawful, merely that a proper inquiry into material market facts is needed. If a defendant can *plausibly* assert that the restraint serves to promote effective cooperation to expand output, further inquiry is appropriate, because it cannot be concluded with confidence that the restraint will be anticompetitive. See 11 HOVENKAMP, *supra*, ¶ 1908, at 252 ("To say that a restraint is 'naked' is to conclude that little plausible basis exists for thinking that the restraint has a significant potential for output expansion.").

The FTC's decision in *Polygram* – in methodology if not result – provides an instructive illustration of this standard. In that case, two recording companies established a joint venture to produce and market a new recording by the "Three Tenors." Separately, they agreed to limit discounting and other forms of competition in the sale of their several previously released, independently owned Three Tenor recordings. This second agreement was deemed by the FTC to be "inherently suspect." *Polygram Holdings, Inc.*, http://www.ftc.gov/os/2003/07/polygramopinion.pdf, at 36. It clearly restricted competition outside of the joint venture, including competition between the parents and competition between each of the parents and the joint venture. In that respect, the agreement arguably posed a greater threat to competition than did the agreement challenged

in this case, which involves only the joint venture's pricing (and not the parents' pricing for sales outside of the joint venture) and parties who, after formation of their joint venture, did not compete against one another *at all*.

The FTC, nonetheless, refused to invoke the *per se* rule in analyzing the restraint. Instead, the FTC examined the defendants' assertion of legitimate justifications for the restraint, *i.e.*,"plausible reasons" that the restraint "may not be expected to have adverse consequences in the context of the particular market in question" or would be likely "to have beneficial effects for consumers." *Polygram Holdings, Inc.*, http://www.ftc.gov/os/2003/07/polygramopinion.pdf, at 29. The FTC defined a "plausible" justification as one that "cannot be rejected without extensive factual inquiry." It did not require the defendant to produce "detailed evidence" supporting its justification, so long as the defendant could "articulate the specific link" to such benefits, sufficient to "merit a more searching inquiry." *Id.* at 31.

The FTC ultimately rejected the justifications that were asserted and found that the restraint unreasonably restricted competition. For present purposes, though, the critical fact is that the FTC recognized that, when a defendant puts forward a "plausible reason" that the restraint may be reasonable, that reason must be considered and addressed, and cannot be rejected out of hand through application of the *per se* rule. In so holding, the FTC followed the approach used by this Court in *BMI, NCAA*, and *Indiana Federation of Dentists*, and by courts of appeals in the *Polk* and *Rothery* cases, by evaluating the asserted justifications rather than applying a formalistic *per se* label and refusing to consider them at all.

Another example is described by the Department of Justice in its *Antitrust Guidelines For The Licensing Of Intellectual Property*, http://www.usdoj.gov/atr/public/guidelines/0558.htm. Those guidelines discuss the appropriate antitrust analysis of field-of-use and territorial restrictions that may be included in intellectual property licenses. If the licensor and licensee would

otherwise be competitors, such restrictions could be described literally as horizontal customer or territorial allocation agreements. But, as the guidelines explain, such restraints:

> may serve procompetitive ends by allowing the licensor to exploit its property as efficiently and effectively as possible. These various forms of exclusivity can be used to give a licensee an incentive to invest in the commercialization and distribution of products embodying the licensed intellectual property and to develop additional applications for the licensed property. The restrictions may do so, for example, by protecting the licensee against free-riding on the licensee's investments by other licensees or by the licensor. They may also increase the licensor's incentive to license, for example, by protecting the licensor from competition in the licensor's own technology in a market niche that it prefers to keep to itself.

Id. § 2.3. Because of their potential value in promoting such efficiencies, such restraints should not be governed by *per se* rules even though they can accurately be characterized as horizontal market allocation. Instead of applying a formalistic label, "[t]o determine whether a particular restraint in a licensing arrangement is given *per se* or rule of reason treatment, the Agencies will assess whether the restraint in question can be expected to contribute to an efficiency-enhancing integration of economic activity." *Id.* § 3.4. "In the vast majority of cases, restraints in intellectual property licensing arrangements are evaluated under the rule of reason." *Ibid.*

2. Courts need not, and should not, rely solely on their own independent assessments of the likely competitive effects of ancillary restraints. Today, most joint ventures of any commercial consequence are carefully examined by one or more expert agencies, *and are approved by the agency*, before a court is asked to pass judgment. The Federal Trade Commission carefully examined the plans for Equilon's formation and operation (including the plan that prices for the joint venture's products would be established by the joint venture and/or its

parents) and reached a considered judgment that the price-setting arrangements challenged in this case would not harm competition, but the Ninth Circuit disregarded that conclusion.

Pre-formation antitrust review and approval of this kind is now the rule, rather than the exception, for joint ventures that might pose a substantial threat to competition. The formation of a commercially significant joint venture usually entails a substantial acquisition of stock or assets that triggers a notification requirement under the Hart-Scott-Rodino Antitrust Improvements Act, 15 U.S.C. § 18a. The Federal Trade Commission and the Department of Justice receive advance notice of such acquisitions, and both agencies have broad authority to investigate and challenge the formation and operation of joint ventures that may impair competition.[7]

The FTC and the Antitrust Division are not the only agencies that evaluate the competitive effects of joint ventures. In many industries, including the telecommunications industry, the competitive effects of a joint venture are also evaluated by a federal regulatory agency. The Federal Communications Commission reviews joint ventures within its jurisdiction under a "public interest" standard that requires consideration of the

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[7] The main point of this brief is that output-expanding, efficiency-enhancing cooperative arrangements take many forms, not limited to separately formed joint ventures like Equilon, and that the Court should make clear that *all* restraints ancillary to *any* such legitimate cooperative arrangement are to be judged – if subject to Section 1 at all – under the rule of reason. Nevertheless, some cooperative arrangements, depending on their form, may receive scrutiny from expert government regulators. When that scrutiny has resulted in a conclusion that a particular restraint is competitively benign, courts cannot treat it as the sort that experience shows to be always or almost always anticompetitive. The rule of reason should always be applicable once it has been determined that a restraint is ancillary to an output-expanding cooperative arrangement, but the folly of applying *per se* rules is especially pronounced when the arrangement is – like Equilon in this case, or the numerous telecommunications ventures reviewed by the FCC – one that has already been flyspecked by expert regulators and approved with the restraint in place.

venture's effects on competition under the principles of the antitrust laws. See, *e.g.*, *Applications of SBC Communications, Inc. & BellSouth Corp.*, 15 FCCR 25,459, 25,466-25,467 (¶ 18) (2000) (defining "public interest" standards that govern review of a joint venture in the wireless telecommunications industry). As this Court recently observed, "'[a]ntitrust analysis must sensitively recognize and reflect the distinctive economic and legal setting of the regulated industry to which it applies.'" *Verizon Communications Inc.* v. *Law Offices of Curtis V. Trinko, LLP*, 540 U.S. 398, 411 (2004) (quoting *Town of Concord* v. *Boston Edison Co.*, 915 F.2d 17, 22 (1st Cir. 1990) (Breyer, C.J.)).

Whether the industry is regulated or unregulated, it is especially misguided for the judiciary to apply a *per se* rule to invalidate a practice that an expert agency, after rigorous scrutiny, has concluded is competitively benign. As this Court recognized in *BMI*, when an expert government agency has concluded that a joint venture restraint is competitively benign, its conclusion provides "a unique indicator that the challenged practice may have redeeming competitive virtues and that the search for those values is not almost sure to be in vain." 441 U.S. at 13. For that reason, if a government agency has concluded that a restraint is benign, a court should rarely, if ever, subject that restraint to summary condemnation under a *per se* rule.[8]

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[8] Aside from the facts of this case itself, another example proves this larger point. The Sprint/France Telecom/Deutsche Telekom and MCI/British Telecom joint-venture agreements approved by the FCC, see Motion, *supra*, included provisions to assign exclusive rights to market the joint ventures' services in defined geographic areas, *i.e.*, a literal "market allocation." The FCC's order approving the MCI joint venture discusses the territorial allocation and concludes, "[W]e cannot discern any significant direct anticompetitive effect flowing from the territorial allocation provision in any market in which the parties would potentially compete in the absence of the restraint." *Request of MCI Communications Corp. & British Telecommunications PLC*, 9 FCCR 3960, 3972 (¶ 54) (1994); see also *ibid.* (¶ 56). Under the Ninth Circuit's rationale

3. The Ninth Circuit incorrectly followed a very different approach in this case. After acknowledging that Equilon was a legitimate joint venture that achieved substantial efficiencies by integrating its parents' marketing businesses, the Ninth Circuit held that the *per se* rule could apply to the defendants' pricing agreement unless the defendants could show that the agreement "is reasonably necessary to further the legitimate aims of the joint venture" – and appeared to equate "reasonably necessary" with "essential." Shell Pet. App. 21a. That standard is inconsistent with any reasonable conception of the *per se* rule because a restraint may be *useful* in achieving a joint venture's legitimate and procompetitive purposes, even if it is not "necessary" or "essential."[9]

The distinction is critical. Very few ancillary restraints can be deemed "essential" (although establishing a price for the joint venture's product fits that description) because *some* alternative arrangement – albeit an alternative that is more costly or less effective – will usually be available to the parties. A standard that demands proof that a restraint is "reasonably necessary" differs only in degree. Business judgments, especially at

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in this case, however, the parties would have borne a heavy burden to escape from application of the *per se* rule to invalidate the "market allocation."

[9] "[I]t is possible, in principle, to demonstrate that a particular [joint venture] operational rule with anticompetitive costs has no offsetting efficiency benefits because the observed efficiencies could be realized by a 'less restrictive' operational rule with no anticompetitive consequences. However, we would urge caution in attempts to imagine 'less restrictive' alternatives to joint venture rules. It is too simple for economists and lawyers, acting as armchair business people, to make conjectures about solutions to joint venture problems that involve less anticompetitive potential. It is quite a different matter to demonstrate that such solutions are likely to work in practice; whereas the rules actually implemented by joint ventures have generally been proven by experience to be functional and stable. Therefore, the argument that there are alternative joint venture rules that are less restrictive must be viewed with a carefully skeptical eye." Chang et al., *supra*, 1998 COLUM. BUS. L. REV. at 286-87.

the *outset* of a cooperative effort, cannot be calibrated so finely, at least with any confidence. Potential participants in a cooperative relationship must consider the risk that a court applying such a standard, with the benefits of both hindsight and the creativity of a plaintiff's lawyer, will conclude that a particular restraint was not "necessary" to achieve their legitimate and procompetitive objectives. If the consequence of such a judgment is that a restraint will be condemned without further consideration of its actual purpose or effect, and treble damages will be imposed, businesses inevitably will be discouraged from entering into many arrangements that would be efficient and beneficial to consumers.

It is particularly bizarre that the Ninth Circuit found it blameworthy – and respondents' brief in opposition treats the case as if it turns on a "finding" – that petitioners may have agreed on the joint venture's pricing mechanism at or before the time the joint venture actually came into existence. Shell Pet. App. 19a-20a & n.11; Br. in Opp. 11-13. As Judge Easterbrook explained in *Polk Bros.*, 776 F.2d at 190,

> The suggestion that the ancillary restraints doctrine does not apply to new ventures also slights the functions of the rule. The partners of a newly-formed law firm agree on fees and allocate subjects of specialty and clients among them; this "price fixing" and "market division" do not become unlawful just because the firm is new. The benefits of cooperation may be greatest when launching a new venture.

As the United States has correctly recognized, U.S. Br. 8-13, 19 & n.20 (filed May 26, 2005), the restraint at issue in this case is not subject to *per se* condemnation, whether it was entered into *before, during, or after* formation of the joint venture.[10]

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[10] If anything, the alleged fact that the partners entered into the restraint before forming the joint venture tends to prove that it was needed to make the concededly procompetitive joint venture work, a sufficient but not necessary condition for application of the rule of reason. At the same time, if the restraint had been entered into after the joint venture was already in existence, it would not follow that it was *not* appropriately

Commercial agreements should be evaluated under the antitrust laws through an "enquiry meet for the case." *California Dental Ass'n*, 526 U.S. at 781. If an antitrust defendant asserts plausibly that an agreement could contribute to the successful operation of an output-expanding cooperative arrangement, that defense should be considered on its merits, not summarily rejected on the basis of formalistic distinctions.

CONCLUSION

The judgment of the court of appeals should be reversed.

Respectfully submitted.

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considered ancillary. See William Kolasky & Richard Elliott, *The Federal Trade Commission's Three Tenors Decision: "Qual Due Fiori a Un Solo Stello"*, ANTITRUST, Spring 2004, at 50, 52-53 (footnotes omitted) ("As Coase and Williamson taught, it is very difficult to draft complete contracts at the time a joint venture is formed. It is essential, therefore, that parties to joint ventures have freedom to alter terms of contact as they learn more about their joint product, market conditions, and each other. * * * Given the difficulty of drafting complete contracts, parties would be far less likely to form joint ventures if they did not have the freedom to later adjust the terms of their agreement to assure that each partner did not behave opportunistically. * * * Denying parties the flexibility to take steps like this after the venture is first formed would force parties to similar joint ventures in the future either to try to negotiate a more costly and comprehensive (and likely more restrictive) agreement from the outset or to forgo such ventures entirely.").